

Standing At The Altar

Charles L. Martin, Jr., Towson University, USA
Benjamin Neil, Towson University, USA

ABSTRACT

This case provides an excellent test of a student's basic knowledge of the residential property real estate process as it relates to having a signed buyer's agreement, pre-approved financing and potential ethical dilemmas. The case introduces students to the purchase of property using the expertise of a real estate agent. It also highlights the need for a formal contract between the buyer and the realtor as well as the potential pitfalls to the buyer and realtor if a contract is not employed.

This case is suited to students taking the first real estate course, those who are taking a course in personal financial planning or those who are preparing to become realtors. After reading and discussing the case, students should have a pragmatic understanding what a realtor brings to the market and why a contractual relationship is necessary for all parties.

Keywords: real estate; buyer's agreement; contracts; ethics; negotiations

INTRODUCTION

The Browns were two, young, married brothers without children that owned four Dunkin Donut franchises in the New Jersey area. They owned and operated these franchises as a family business with all four adults involved in the day-to-day business. The two brothers managed the business behind the scenes handling the paperwork and planning future expansion while the wives were front and center in the shop and managed the employees. The brothers were the principals and considered themselves wheeler-dealers as businessmen, especially in front of their wives.

The couples were extremely close working and living together in an apartment. Their apartment no longer satisfied their need for living space and was not providing any equity, so they decided to purchase a house. A house that would accommodate the wheelchair bound brother and provide space for growth as the families grew with children.

At the time of their search, the real estate market was taking a tumbling fall with a large and growing inventory of homes on the market. Interest rates were climbing at the time due to the increasing Fed rate, poor job market, foreclosures, and bank failures. However, it was still a good buyer's market because the decrease in home values more than offset the increase in mortgage rates.

PREMISE

The Browns were new to the real estate home market, but they were not new to negotiating. They contacted a local real estate agent, Jim Douglas, and requested representation in searching for a home. They did not care if the agent was a 'buyer's agent or a dual agent'. However, they were interested in a seasoned agent, such as Jim, who had 15 years of experience as a realtor. Upon meeting the agent, the Browns indicated that they were interested in a four-bedroom house with a detached garage and handicap accessible which they would own and live in jointly. As was his customary way of doing business, Jim did not have the buyers sign a buyer's agency agreement, nor did he have them financially pre-approved.

Over the course of five weeks, eleven homes were shown at various times, day and night. The Browns always made the agreed-upon appointments and thoroughly evaluated each potential home. During this time, a very

comfortable relationship was developed between the realtor and the Browns. The clients opened up more and more as time progressed, indicating their plans for acquisition of more Dunkin Donut franchises as well opining about their excellent negotiating skills.

A large rancher, which had been on and off the market over the past year, was relisted with a substantial decrease in asking price. The rancher had easy access with wide doors and only one step for the handicapped brother. The home had four bedrooms, 2 ½ baths and an oversized detached garage. The property had everything the buyers desired and more. Furthermore, since the owners of the property had already moved out of town and had purchased the property only a few years earlier when the real estate market was at its peak, they needed the cash so they were willing to take a loss on the sale. A perfect storm was in place for the buyers.

The Browns were very interested in the house, but their ‘interest’ wouldn’t interfere with the brothers showing off their negotiating abilities. To start the negotiating process, contrary to the advice of their realtor, the Browns low balled the already low listing price. According to the seller’s agent, the low ball incensed the sellers. The sentiment expressed by the sellers towards the low ball was forwarded by the buyer’s realtor to the buyers; however, the sellers did counter with a drop in price. The buyers then countered with an increase in offer which was still lower than the reduced price and the seller’s countered with a ‘meet-in-the-middle difference’. This exchange took place over three days with the buyers deciding to see the house one more time.

Upon revisiting the house, the Browns expressed their extreme pleasure in what the property had to offer, but they wanted to offer less than the ‘meet-in-the-middle’ counter. Their realtor, Jim Douglas, based upon his discussions with the seller’s agent, indicated that he felt the sellers would not be pleased with the counter and may well walk away from the negotiations. To support Jim’s strong feeling about the ultimate outcome, he bet the Browns \$20 that the offer would be rejected and that the sellers would no longer negotiate. The Browns accepted the bet countering with a lower than ‘meet-in-the-middle’ figure. It was communicated through the seller’s agent to Jim then to the buyers that the sellers were irate and wanted nothing to do with the buyers. Jim collected his \$20 from the Browns. Jim headed to the realty office while the Browns went home, leaving the property in their separate cars.

On the way home, the Browns realized their mistake in not listening to their realtor. They called Jim requesting that he contact the seller’s agent offering a ‘meet-in-the-middle’ price. The sellers verbally agree to the terms of the contract.

The Browns then informed Jim that it is their parents, who live in India and have been very successful in business, who are actually going to buy the house. In fact, the parents provided the financing to purchase the four Dunkin’ Donuts franchises, that they are operating. According to the Browns, the parents have been pre-approved with supporting documentation available. The Browns were to arrive the next morning with an earnest money deposit. A contract with appropriate names was completed and faxed to the parents. The fax number was found not to be viable. A call was made to the Browns whereby they provided an alternative fax number. The fax was partially processed when the receiving number disconnects. The number continued to be inaccessible. The Browns don’t answer their phone. The next day the Browns do not bring in the earnest deposit, nor do they answer their phone. By the second day, the buyer’s agent, Jim, realizing that the Browns were not going to honor their verbal agreement with a written contract, leaves a message on the Browns’ phone indicating that he will no longer serve as their agent. The Browns never respond.

Approximately 55 hours of work with no financial benefit other than the \$20 bet. This is a case where the buyer’s agent was left standing at the altar.

QUESTIONS

1. What is the purpose behind having a buyer’s agreement and pre-approved financing? How did Jim’s standard practice of not having a signed buyer’s agreement and not having the client financially pre-approved hurt him?

2. Comment on the Browns negotiation strategy incorporating the information about the seller's perception into your thoughts.
3. Was Jim's bet with the Browns ethical? Explain.
4. Should the earnest money deposit, which would have been paid by the Browns, be disclosed as not coming from the true buyers of the property but from the parents?

AUTHOR INFORMATION

Charles L. Martin Jr., CPA, DBA serves as Professor of Accounting at Towson University, located in Towson, Maryland. Over the last thirty-five years, he has published over 27 manuscripts in various academic and professional journals. Dr. Martin was named Maryland's 1999 Outstanding Accounting Educator by the Maryland Association of Certified Public Accountants. In early 2000 and 2001, Dr. Martin served two faculty internships; one in public accounting and the other in financial planning. He can be contacted at CHMartin@Towson.edu.

Benjamin A. Neil is an Associate Professor of Business Law and Legal Studies at Towson University, located in Baltimore, Maryland. He has published other works relating to real estate issues and has presented at numerous conferences. He can be contacted at bneil@towson.edu.

APPENDICES

TEACHING NOTES

QUESTIONS

1. **What is the purpose behind having a buyer's agreement and pre-approved financing? How did Jim's standard practice of not having a signed buyer's agreement and not having the client financially pre-approved hurt him?**

The buyer agency agreement is an employment contract. The broker, of whom the realtor is the agent of the broker, is employed as the buyer's agent. An agency agreement gives the buyer a degree of representation possible only in a fiduciary relationship. A buyer's broker must protect the buyer's interest in all points in the transaction.

There are three basic types of buyer agency agreements:

1. Exclusive buyer agency agreement is a completely exclusive agreement whereby the buyer is legally bound to compensate the agent whenever the buyer purchases a property of the type described in the contract. The broker is entitled to payment regardless of whether he or she locates the property. Even if the buyer finds the property independently, the agent is entitled to payment.
2. Exclusive-agency buyer agency agreement is similar to an exclusive buyer agency agreement and is an exclusive contract between the buyer and the agent. However, this agreement limits the broker's right to payment only if he or she locates the property the buyer ultimately purchases. The buyer is free to find suitable property without obligation to pay the agent.
3. Open buyer agency agreement is a non-exclusive agency contract between a broker and a buyer. It permits the buyer to enter into similar agreements with an unlimited number of brokers. With an obligation to compensate only the broker who locates the property that the buyer ultimately purchases.

Pre-qualified is really the first step in the mortgage process. From the information that is provided, the lender can get an idea of the mortgage amount for which the individual qualifies and it can usually be done at no cost. The borrower should be aware that they are not actually approved for a loan at this point, and the mortgage lender only has their word regarding their income, assets and liabilities.

Pre-approval is the next step in the mortgage process. It requires the borrower to complete a mortgage application, known in the business as a Form 1003. The borrower must also supply the lender with all the necessary documentation to check their personal financial background and credit rating. Then the lender will be able to state the exact amount of a mortgage for which they are approved. Once approved, the borrower can request a letter from the lender stating how much money they can borrow. However, neither option is a "guarantee" that the mortgage application will ultimately be accepted by the lender.

If Jim had required a signed buyer's agency agreement and a pre-approval of financing, he would have been aware the Browns were really not the buyers. The parents were the buyers. At that time, he could have evaluated the risk/reward return on this relationship.

2. **Comment on the Browns negotiation strategy incorporating the information about the seller's perception into your thoughts.**

The economy, being what it was with unemployment growing, foreclosures hitting the market, and the tripling of the housing inventory within a short period, certainly dictated that it was a buyer's market. Negotiating with home owners who had their home on the market for an extended period of time permitted buyers to have a great deal of leverage. However, negotiating should be done in good faith. The Browns did not exhibit good faith, nor did they listen to a more subjective side of the process. They were only interested in negotiating through numbers without considering what the seller was saying about their negotiating tactics.

Jim provided the buyers with the comments and feelings of the sellers when he stated that the sellers were initially incensed with the low ball offer and the continual undercutting counter-offering price made by the buyers. The buyers were warned by their agent, based upon subjective professional analysis, that the sellers would walk away from another undercutting price.

3. Was Jim's bet with the Browns ethical? Explain.

Although Jim was trying to make a point by betting that the last counter-offer was not going to be well received by the seller, the act of monetarily betting against your client's actions appears to be unethical in that it runs contrary from 'protecting your client's interest'.

Ethics are a set of principles about right conduct and behavior. Business ethics dictate right conduct when it comes to interacting with colleagues, competitors, clients or the public. It is a responsibility that every individual must bear if he is to succeed.

Most people, when looking to hire a real estate agent want someone who is ethical and trustworthy. The Code of Ethics for an agent is listed by its respective company, the area or state regulatory agencies, the National Association of Realtors (NAR), or other such associations or agencies.

Each association or board will have its own Code of Ethics laid down for its associates and employees. Depending upon the association the agent belongs to, they must adhere to their rules and regulations. However, most of these codes have a common thread that runs through them. They all demand rightful and proper representation of the client and agreeable behavior when you are on the job.

Ethics also come into play when it involves the small details, such as when the agent engages in a "bet" with his client. In the end, good ethics equates to good business.

4. Should the earnest money deposit, which would have been paid by the Browns, be disclosed as not coming from the true buyers of the property but from the parents?

Most offers to buy a house are accompanied by a check. The check is generally referred to as an "earnest money deposit". The basic reason for the deposit is to show the seller that the buyer is serious about buying the property.

Underwriting guidelines sometimes require a strict documentation of such deposits. A buyer may often be required to show a cancelled check along with a bank statement just prior to the date of the check, plus evidence that the check actually cleared the bank.

This is generally considered a "source of funds" requirement, and if it comes from the parents, it would need to be listed specifically as "gift funds". In either event, the source of funds for the initial deposit might well disclose the true buyers who, in this case, are the parents.

Once a buyer and seller agree to terms, the earnest money deposit is usually placed in a "trust" account, typically with a well-known real estate brokerage, legal firm, escrow company or title company.

Remember that states set their own legal limits as to the amount of earnest monies allowed.

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